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Web Ordering May Alter Role of Distributors

(Increasing use of the Internet to distribute home improvement and home building products may eventually eliminate the need for retailers)

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Abstract:
The emergence of the Internet as a new medium for selling and buying products and services may change the role distributors of home improvement products play in the distribution chain. Indeed, distributors may find themselves changed into electronic clearinghouses that link consumers to manufacturers through the retailers. As electronic clearinghouses, distributors would receive and arrange product orders placed via retailer's Internet-wired kiosks. They then would quick-ship or deliver the products ordered to the consumer's home or to the retailer. In such a set up, not only do distributors provide ordering convenience to consumers and retailers, they also offer them lower-priced products since they still buy home improvement products from manufacturers in large numbers. Distributors themselves also benefit from becoming electronic clearinghouses. For one, they get credit for the sale of home improvement products even if they did not physically handle product orders. They are also able to cut their operational costs since they do not have to receive, store, and ship product orders without the need to do so: Article enumerates several developments that signal the coming of electronic commerce in distribution.

Text:

BY CAROL TICE
It's 2002. Computerization and the Internet have created efficiencies in the distribution of home improvement and home building products that require only one-fifth the number of workers employed by the industry today. Consolidation has whittled this industry segment to those survivors which have positioned themselves either as electronic clearinghouses for product information and ordering or as just-in-time delivery specialists with convenient branch locations -- or both.
This is the future of distribution as anticipated by Bruce Merrifield, a Harvard M.B.A. and former owner of several distribution companies who for many years has been a regular on the seminar circuit as an expert on wholesaling and distribution (see Scenario 2002).
His future, though, would be a dramatic departure from present realities, where conventional distribution -- orders taken by telephone, fax or computer by distribution centers that ship products to stores, job sites and, on rare occasions, homeowners -- prevails and, in fact, flourishes. Ordering via the Interact is not yet the glitch-free phenomenon Merrifield and other industry experts tout it to be or become.
A visit to contractorstools.com is instructive. Founded last fall, this Web site offers discounted pricing on tools from several dozen manufacturers. But repeated attempts by an NHCN reporter to get onto the site in early June found that it had no contact telephone number or street address. An e-mail to the

site went unreturned. Nine times out of 10, accessing the site caused a computer crash.

Other sites that purport to be building materials purchasing clearinghouses, such as Build.net and Build.com, are full of merchandise categories that presently are without manufacturer links.

The time when ordering products over the Internet will be easier and faster than picking up a phone has yet to arrive. Nevertheless, distribution and technology experts say that over the next few years, this may well change.

Online commerce ready for takeoff

First, they insist that advances in technology will make electronic commerce faster, simpler and cheaper, enticing more buyers and sellers into the medium. Online shopping for all products, which was a $3.3 billion retail business in 1997 according to a CyberDialogue study, is expected to grow to $17 billion in 2001, says an optimistic estimate by Forrester Research. In the home improvement field, businesses' embrace of online selling will accelerate as a younger, computer-literate generation takes the helm at more companies. More controversial, though, is the prediction in some quarters that online selling won't disrupt -- and in fact could enhance -- the relation between distributors and retailers.

The rise of electronic commerce will present new challenges to distributors. They may find their role threatened by upstart "virtual companies" that seek to bypass both retailers and wholesalers and simply connect the end user to the manufacturer. And they will be called upon to offer ever more rapid delivery to match the online buyer's expectations of instant gratification. As David Myer, retail support vice president at the buying group Ace Hardware, noted, "The pressure is going to be on that fulfillment process to match the immediacy the Web site offered."

Distributors and retailers of home improvement products have been linked for years via electronic data interchange (EDI). But some in the industry remain leery of online selling in a business where the most important connection is between two human beings: the customer and the salesperson.

The viability of e-commerce wasn't strengthened, either, by the recent travails of Georgia-Pacific, whose attempts to substitute electronic interaction between itself and its retailer customers for a wide network of DCs servicing local markets has been, to this point at least, a financial disaster.

However, this trepidation about e-commerce also betrays a justifiable anxiousness among distributors and dealers about the inevitability of online selling and how it will reshape the business.

Improving the supply chain

Merrifield envisions a world of electronic selling in which customers would still go to a retail store. There, in addition to the on-hand selection of products, they would find an Internet-wired kiosk through which they could view, and special-order, a wide variety of merchandise from that retailer's supplier.

The order would be transmitted immediately to the distributor, which could quick-ship it either to the store or the customer's home. Manufacturers would rely on their distributor networks to avoid having to deal with millions of tiny orders themselves.

Distributors would get credit for the sale, even though they had not physically handled the product. They'd provide the services of convenience to retailers and shoppers by serving as a clearinghouse for many different product lines.

Eventually, as computer-savvy customers got accustomed to the system, they would start to ask if they could access the retailer's ordering system without coming into the store. The retailers would give the customers a password, coded to credit their store with the sale of an order placed electronically. In this way, say Merrifield and some industry observers, the distribution chain would remain unbroken and benefit profitably from reduced staffing

needs, as customers begin to serve themselves on their home computers. The retailer would remain as a source for how-to information, product assembly, project design help, and warranty and repair work.

Costs are taken out of the chain by this "virtual warehousing" approach. Less staff and warehousing space would be needed as orders are taken electronically and shipped directly from manufacturers to customers.

One believer in this future model is Paul Lemerise, executive vp-systems and distribution for the buying group TruServ, which currently services 10,300 dealer-members through 21 DCs nationwide.

"I could see the majority of our business becoming a virtual warehouse that you get to through the Internet," he said. "We become an electronic clearinghouse, where the service we provide is linking the consumer through the retailer to the manufacturer. We offer lower prices because we're still buying from the manufacturer in very large quantities. And I've taken all the cost out of my business because I don't have to receive it, store it and ship it."

Indeed, a rudimentary form of virtual warehousing -- drop-shipment from manufacturer to either the store or to an end user, usually a professional customer, on behalf of the distributor -- has long been a reality for the industry's five largest dealer-owned hard- lines co-ops, which did 41 percent of their business through these orders in 1997. Half of Do it Best's wholesale sales came from drop shipments last year.

Many proponents of e-commerce believe that there's no reason why even the bulkiest home improvement products couldn't be sold over the Internet, and they bolster their opinions by pointing to the impact electronic commerce is having on the auto industry. Just ask Lemerise, who recently bought his new car through the online wholesaler AutoByTel.

Lemerise used AutoByTel's Web site to contact the auto maker of his choice, choose a model and indicate the options he desired. His local dealer then took delivery of the car and brought it to his office along with the paperwork for Lemerise to sign. The deal was accomplished without Lemerise ever setting foot in a showroom, much less being subjected to the traditional price-haggling ordeal. The process was so satisfying that Lemerise doubts he'll ever buy a car the old-fashioned way again.

The future that's already here

Those who find it difficult to believe electronic commerce would work in the home improvement industry need only look to several recent developments to observe elements of this new, electronic supply chain already under construction.

* In May, Do it Best created a Web page for its industrial/commercial (I/C) division, InCom Distributor Supply. From that page, dealer-members can look up catalog items and "hot-link" to vendor sites to place orders directly, with the co-op receiving credit for their purchases.

* Earlier this month, Home Depot announced that its Maintenance Warehouse I/C division will begin offering electronic Internet ordering to its customers within 60 days.

** In July, Wickes Lumber will debut its 65,000-sku toolsonline.com Web site, a joint venture with a sister company called Cybermax. The toolsonline site will be the first within the industry to offer Internet resale commissions to other Web pages that link customers to their site, a system pioneered by bookseller Amazon.com.

* In August, Dallas-based e-commerce firm FPIX will debut the first real-time electronic lumber trading system. Some wholesalers haven't quite taken the e-trading leap yet, but are poised to do so. For example, McFadden's Hardwood & Hardware, based in Oakville, Ontario, links all four of its branches to its Web page and equips its field staff with laptops that allow them to tap into the page for electronic pricing, credit information and ordering.

McFadden's president, John Stafford, said he's moving ahead with plans to extend that technology to his company's customers, which are mostly retailers,

woodworking shops and institutions. "We'd like to have our customers having completely secure access to our inventory and pricing and be able to purchase online 24 hours a day," he said.

But the real challenge to home improvement distribution in the future may not be these sorts of electronic commerce partnerships, but the emergence of entirely new e-commerce entities that have no loyalties to the status quo. "This technology can make a single person in their garage look big and successful," said Ace's Myer.

Stafford of McFadden's agreed. "It could be somebody who's not even in the business now," he said. "If you had no current allegiances to anybody, it would be easy to come on the Internet and say, 'My idea is to sell anybody with a MasterCard, and I don't care about the way things have been done before.'"

Delivering the goods

While some companies have focused on speeding ordering through e-commerce, others are using technology to create a more efficient product delivery system. And there's no expectation that e-commerce will make the physical distribution network disappear completely.

The Internet simply provides a faster, less expensive way to gain information about products and order them, Merrifield noted. Goods will still have to get from here to there, and whoever can do that quickly and cost-effectively will be out in front.

For example, by the end of 1997 Orgill, the industry's largest independent hardlines distributor, was capable of taking a special order from a retailer in the evening and shipping it to the end user by the next morning. Orgill's president, Bill Fondren, said the eventual goal is to be able to ship product 24 hours a day.

The delivery challenge is greater for building materials distributors than for hardlines wholesalers, which are increasingly using UPS overnight shipping. When it comes to bulky, difficult-to-ship commodities, there appears to be no technological substitute for being located within overnight-delivery range of customers.

As a result, some distributors, like Cameron Ashley Building Products, are expanding their network of locations aggressively to be able to serve more customers. Cameron Ashley's chairman, Ron Ross, said his company hopes to grow from its current 150 locations to as many as 300 in five years.

"We'd like to be able to serve 85 percent of the North American population base by 2002," he said. The company's size, Ross noted, also gives it the capitalization to invest $11 million in new technology, which it is currently doing.

The company hopes to use its new computer system to increase use of computerized inventory-tracking through bar coding, as well as increasing its capabilities for EDI and vendor-managed inventory. Its field staff should be using the Internet for ordering by the end of 1999.

Other wholesalers are still experimenting with how many locations are really needed to serve their customer base. Jim Arthurs, general manager of operations for MacMillan Bloedel's building materials division, said, "It comes down to what's the right balance between the efficiency of bigger locations without losing the effectiveness."

MacMillan Bloedel announced in January that it would close seven locations but ended up closing nine. Older, smaller facilities, including one in Tampa, Fla., were closed in favor of larger ones with more up-to-date technology, such as the company's DC in Jacksonville, Fla.

"Our real value is in supply-chain integration," Arthurs said, "linking our suppliers and our customers so that things flow smoothly from the tree to the job site."

David Still, vice president and general manager at Weyerhaeuser's building materials distribution division, agrees that location remains the key to providing services, one of the most crucial things distributors now offer.

"Our customers need just-in-time inventory, more vendor-managed inventory, they need employee training and other services that almost demand that you be there close by," he said. "The Internet is only a tool. The strategy is meeting customer needs."

For the time being, one of those customer needs may be for good, old-fashioned, low-tech human interaction. Stephen Boyd, president of Manufacturers Reserve Supply in Irvington, N.J., and current president of the North American Wholesale Lumber Association, notes that the average age of his customers is "50-plus." Only a very small percentage of them are computer-literate, he said.

"In my eyes, people want to be able to interact with a live person and get their specific request answered without reading 17 pages of Internet instructions," Boyd said. "We are committed to the personal touch. And I think these customers will ultimately be willing to pay for that."

But, he conceded, "as the younger generation starts to own these companies, that may change."

Technological savvy doesn't provide sales edge yet

Breakdown of 218 wholesalers, co-ops and marketing groups by EDI use and Internet Web site presence for 1997

EDI No, Web Site No.	26.1%
Sales growth:	6.4%
DC growth:	3.1%
EDI Yes, Web Site Yes	25.7%
Sales growth:	5.8%
DC growth:	13.0%
EDI Yes, Web Site No	40.8%
Sales growth:	1.1%
DC growth:	-5.6%
(excluding G-P, DC growth is 2.8% and sales growth is 3.8%)	
EDI No, Web Site Yes	7.3%
Sales growth:	4.2%
DC growth:	18.0%

Spinning a Web

Percent of polled distributors with Internet Web sites

'95	3.6%
'96	15.3%
'97	33.0%

NHCN research

SCENARIO 2002

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Expert envisions a smaller, technology-driven channel

Distribution expert Bruce Merrifield foresees radical change in the distribution channel over the next five to seven years. In this excerpt from one of his articles, he outlines the shape of one possible future for distribution.

1. CONNECTIVITY TO THE INTERNET

A. Any business that matters will have a continuous connection to the Internet -- a universal datatone for phone, fax, data, etc.

B. Every person in the U.S. will have at least indirect access through computer stores, libraries, schools, many retail stores.

C. Most homes will have smart phones, Web-TV, or onramp service to the Internet.

D. Videoconferencing will be commonplace in business and the media and the public will have lost interest in most web-volume statistics.

2. E-MAIL ADDRESSES WILL BE IMPERATIVE for all business people and most citizens. It may not be some people's sociological choice, but push/pull information and communication needs and total network value will force most

people to be there.
3. FOR ALL BUSINESS BUYERS, there will be a number of one-stop, total informational "infomediaries" that will offer just-in-time push/pull information, education and even wisdom for a fee. Also, they will offer comparison shopping for the goods with the possibility of doing a transaction on the spot.
4. CUSTOMER EXPECTATIONS WILL GROW to always expect to be able to buy:
A. However they want (unbundled, fee-for-service, or a la carte).
B. Whenever they want it (24 hours a day, 7 days a week).
C. From wherever (many will be in mobile, wireless contact).
D. Faster. If they order it at night directly from the manufacturer, and the wholesale distributor gets a virtual reseller commission check quarterly, the order cycle time will be reduced.
E. For less. If there is savings in self-service, they will expect a functional discount, like other competitors will offer.
5. AN INTERACTIVE SCENARIO: Customers will download information from "push" technology news services, full of data about the industry and products in which the customer has expressed interest. Their wholesaler will have partially redeployed its sales organization and administrative services staff into specific information specialists, each with a specialty knowledge area. The customer will contact these knowledge experts to learn about and purchase the products they want electronically.
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Cited References:

Special Features: Table
Company Department Name: Information Technology; Marketing & Sales
Industry Names: Retailing non-food
Product Names: Building materials, hardware, garden supply, and mobile home dealers (520000)
Concept Terms: Information Technology; Marketing & Sales; Distribution channels; Electronic commerce; Internet; Outlook
Geographic Names: North America (NOAX); United States (USA)

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U.S. and Foreign Commercial Service (US&FCS)

INDUSTRY SECTOR ANALYSIS
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Domestic production:

Domestic production of paints and coatings for 1997 was estimated at US$1.21 billion, a nominal increase of four percent, compared to US$1.16 billion in 1996. Shipments expected to continue growing 1998, and total Canadian production this year is forecast to reach around US$1.28 billion.

The structure of the paints and coatings manufacturing industry in Canada reflects the structure of the market. In 1995, the most recent year for which Industry Canada has full figures, 62 of Canada's paints and coatings manufacturing plants were located in the province of Ontario, 34 were in Quebec, 13 were in British Columbia, four were in Alberta and Manitoba, two were in Nova Scotia, and New Brunswick, Newfoundland, Prince Edward Island and Saskatchewan each had one plant.

Larger plants, whether of Canadian companies or subsidiaries of multinational companies, are primarily located in Ontario and Quebec. The top 10 producers in Canada account for the majority of production. Giants like ICI, Du Pont, BASF, Valspar and Benjamin Moore all operate production plants in Southern Ontario, while Akzo Nobel, Benjamin Moore and ICI, among others, have plants in the Montreal area. These plants produce different product lines for distribution throughout Canada. They also bring products in for distribution have North American production mandates for different types of products and supply both the U.S. and Canadian markets for these lines. Thus cross-border production and distribution are highly integrated. This integration has been possible largely because of the elimination of tariffs under the Free Trade Agreement (FTA) between the U.S. and Canada and under NAFTA, because of the streamlining of border controls and because of ever improving trucking systems and ever lower transportation costs.

Canadian manufacturing plants tend to be smaller than foreign-owned plants. However, there are notable exceptions, the most visible of which is Sico, a Quebec-based company which has a handful of plants in the provinces of Quebec and Ontario and has operations in northeastern United States. Sico is the largest Canadian-owned paints and coatings manufacturer, and is a clear leader in the Quebec market for architectural paints, where it holds a more than 50 percent market share and is also an important player in the industrial paints segment in the area.

The smaller size and generally more limited economies of scale of Canadian manufacturers are reflected in the lower average shipments per employee and the lesser amount of value added per employee compared to the United States. For example, in 1995, the figures for total shipments per employee in the United States were about 72 percent higher than in Canada. Similarly, the amount of value added per employee in the United States was about double what it was in Canada. These figures should be interpreted with

caution, however, because differences of definition and method of measurement, and because they describe quite different industrial bases.

Many domestic manufacturers have chosen to develop wide lines of products that they distribute largely on a regional basis. In doing this, they achieve good name recognition and offer solid customer service without having to incur the high overhead costs associated with maintaining and supporting a truly nation-wide distribution network. Other domestic manufacturers have chosen to develop specialty products and operate in niche markets, usually on a broader scale, territorially, than the companies with wider lines.

Competitive pressures and tough market conditions have affected both the marketing of paints and coatings and the operations of manufacturers in Canada. In many cases, manufacturers have embarked on major initiatives to improve efficiency, streamline production, and raise competitiveness. One good measure of this is the decline in the ratio of employees in administration to employees in production 1996. Even though these ratios have also declined in U.S. industry, the change has not been as drastic: the drop was from 98:1 in 1990 to .89:1 in 1995 in the United States

In investment, the Canadian paints and coatings industry is registering modest but steady growth, with total capital stock within the industry standing at CDN$0.7 billion in 1996, representing a compounded average annual growth rate of 4.7 percent over 1988 figures. During that eight-year period, the stock value of machinery and equipment grew at a compounded average annual growth rate of 8.1 percent, 1988 to over CDN$45 million in 1996, reflecting the move to increased technical capability and production capacity. Growth in the stock value of construction, percent.

Many Canadian manufacturers, even relatively small ones, have followed the trend in Canadian manufacturing to initiate programs for ISO 9000 certification. Some have already completed the process, which should give them an advantage when dealing with large end-users in the manufacturing sector who see the ISO standard as a means of ensuring constant product quality from their suppliers. Generally speaking, companies that go through the ISO certification process refine all aspects of their business, service, improving their overall competitiveness and presenting themselves as serious competitors.

Exports, which used to account for only a small proportion of Canada's production of paints and coatings, have increased significantly over the last decade. Only two percent of Canada's domestic production was exported in 1990, and in 1998 that percentage could be as much as 15. Canadian exports of paints and coatings are expected to increase 22.1 percent in real terms in 1997 over 1996, reaching an estimated US$161.9 million. Strong export performance should continue in 1998, driving exports up 18.4 percent to a forecasted US$196.1 million. These exports are being fueled favorable exchange rates, increased sectoral integration in North America, increased competitiveness aggressive marketing.

U.S. Market Position and 3rd-Country Imports

The United States market accounts for 95 percent of Canadian exports of paints and coatings. Other export destinations each account for less than one percent of exports (less than US$1 million per year), the main ones being Hong Kong, China, Argentina, Poland, Cuba and Germany. The United States is expected to remain Canada's only significant export market for paints and coatings, at least in the foreseeable future, though some manufacturers may take advantage of occasional specialized opportunities in some other countries.

Similarly, imports share of Canada's paints and coatings market. The United States accounted last year for about 94 percent of imports of paints and coatings into Canada. Other countries Canada imports Germany (1.7 percent of imports), the United Kingdom (1.2 percent), Japan (0.5 percent), the Netherlands and France (0.4 percent each) and Italy (0.2 percent). Imports countries are generally composed of specialty products serving specific niche markets and produced to large international firms like ICI or BASF. Given the high transportation costs associated with importing paints and coating products in imports future.

C. END-USER ANALYSIS

Client needs in the Canadian paints and coatings market vary depending on the type of product. However it is fair to say that product quality,

competitive pricing and technical support play a major part in the client's choice.

Competition has increased in the industry over the last 15 years with limited demographic growth in North America, slower economic growth than in earlier decades, changing distribution channels at the retail level and increased industry concentration. In response to increased competitive pressure, most companies have streamlined production and improved productivity. However, the nature of the paints and coatings industry, limits to plant size due to safety and environmental hazards, and transportation costs have put limits on the economies of scale that manufacturers can achieve Therefore, manufacturers have tried to gain an advantage on other fronts such as product development, customer service, technical advice, point-of-sale support, merchandizing and promotion.

Architectural paints:

Change in marketing and merchandizing have affected all segments of the market, but they have revolutionized the architectural paints segment in particular at the retail level. While traditional, basic paint products are still in high demand, consumers increasingly request paints with additional features like improved scrubbability, durability, adhesion and opacity. Not only have clients become more demanding and sophisticated regarding the quality of the products they purchase, they also demand more innovative products. Retailers and consumers ask for enhanced color palettes, with professionally developed fashionable color matching. Retailers also note increased demand for special decorative products such as special effect paints, multicolor paints, faux-finishes and special glazes. Sales volumes on these products are lower than for mainstream lines, but they could present good potential for suppliers able to provide point-of-sale support, and training on the use of the products for do-it-yourself clients.

The growth of the specialty paint market, increased competition, and the emergence of large, service-oriented retail chains and do-it-yourself centers such as Wal-Mart, Home Depot, Reno Depot, Rona L'Entrepot and Ace Hardware, have changed the relationship between manufacturers and paint distributors. Competition for shelf space in major retail outlets is keen. Suppliers who want to secure visibility in the high-volume market segment need to commit significant resources to training sales staff, sharing promotional costs and offering point-of-sale support, including elaborate color displays and color cards, product demonstrations, decorating seminars, and other presentations. This is a cut-throat market where profit margins tend to be lower, delivery schedules are tight and the addition of new product lines is heavily scrutinized. Retail giants and mega-stores, which are a relatively new phenomenon in Canada, are accounting for an increasing proportion of retail sales of architectural paints and coating products in Canada. Though it is difficult to establish precise market share, it appears that gains made are principally affecting the sale of paint and smaller building product retailers. However, a number of department stores and hardware chains such as Home Hardware, Sears Canada, Canadian Tire, the Rona Group and the Sodisco-Howden Group remain driving forces in the sale of architectural paints because of their high sales volume and extensive retail networks.

Even though increased competition has caused casualties and forced a streamlining of operations, specialized paint and decoration stores occupy a niche that is attractive to many customers and manufacturers. These stores rely on personalized customer service, integrated decoration counseling and convenient locations. Whether they are independent, franchised, or corporate-owned, they have managed to hold their ground against large retail operations.

Domestic producers in Canada, be they Canadian or foreign-owned, mostly manufacture architectural paint products sold in Canada under their own brands, private labels or generic names. However, some of those producers sell high-end, premium-quality or specialty U.S. products. There are also large integrated U.S. manufacturers serving parts of the Canadian market from conveniently located U.S. plants for specific product lines. While leading North American brands enjoy strong popularity and market share across the country, domestic producers of regional brand names in architectural coatings have also established a strong presence, even achieving market dominance in some parts of the country. This is particularly true in the province of Quebec

where regional Canadian-owned suppliers clearly have the upper hand in many segments of the market, thanks to strong product recognition and sustained market visibility.

Automotive OEM coatings:

As mentioned above, the automotive coatings sector in Canada is a very concentrated market, dominated multinational players. The Canadian and U.S. automotive industries are very integrated, and relationships between automotive and coatings manufacturers are well established. Competition is nevertheless sharp, and ongoing research and development plays a critical role in success. Sales to the OEM sector are made through the manufacturers' own corporate sales forces.

Automotive refinishing paints and coatings:

In the auto-refinishing sector, industry concentration is also very strong, but the market is somewhat more accessible to other players, as the customer base is wider than for the OEM segments, and accounts are more spread out geographically. Most sales are made through major auto parts chains, which supply body shops and paint shops across the country. In recent years, Canadian auto parts distribution has undergone a major consolidation leaving four national distributors, UAP, Uni-select, Carquest and Autovalue, to share the bulk of the market. Manufacturers interested in introducing products to these distributors can approach them directly or through the help of manufacturers' agents. Because of Canada's particular geography and location of its population, and because of the importance of quick delivery times, it is very difficult to achieve national market coverage without dealing with one of the national distributors that have extensive service networks across the country. These large distributors usually focus on selling a full line of refinishing products for one of the major suppliers, but they are often open to taking on additional specialty lines for nationwide or regional distribution.

Jenston

Other industrial coatings:

Most other industrial paints and coatings are sold directly from the manufacturer to the end-user through the manufacturer's own sales force or manufacturers' agents working on commission. In addition to quality and pricing, factors such as personalized service, short delivery times, and technical support are particularly important for many parts of this segment. Generally speaking, sales in this diversified segment are made in the provinces of Quebec and Ontario, which have the highest concentration of manufacturing and industrial activity in the country.

To understand how the Canadian paints and coatings market is structured, it is important to review some of the basic features of the country's geography, its economic activity and its demographics. Canada is a large, sparsely populated country, stretching across the whole continent with most settlements and economic activity within a few hundred miles of the United States border. Canada can generally be divided into five distinct markets: the Atlantic Provinces (including Newfoundland and Labrador, Nova Scotia, New Brunswick and Prince Edward Island), Quebec, Ontario, the Prairie Provinces (Manitoba, Saskatchewan, Alberta and the Northwest Territories) and the West Coast (British Columbia and Yukon). Each of these regions has its own characteristics which companies interested in selling paints and coatings to the Canadian market should be aware of.

Atlantic Canada is roughly the size of France and has a population of approximately 2.5 million people. Given the long distance between this area and the major centers of Montreal and Toronto, regional distribution is often required to achieve a good presence in the area. The region is a net importer of finished products and a net exporter of resource-based and semi-finished products. Niche markets of particular interest in this region are marine coatings, offshore coatings, yacht paints, and general industrial coatings for heavy equipment maintenance.

Quebec is a predominantly French-speaking province of seven million people. It has a diversified economy centered around Montreal, the country's second largest urban center. It is the most important Canadian area in terms of industry concentration and manufacturing activity after Ontario. With its economic and manufacturing sectors, the province of Quebec is a relatively strong market for architectural paints, ground transportation OEM and refinishing coatings (trains, buses and trucks), aerospace coatings,

automotive refinishing products, furniture, major appliances coatings (electrocoat), paints for plastics, and general industrial coatings. The strong presence of industries like the pharmaceutical, pulp and paper, food processing and chemical formulating industries also generates opportunities for suppliers of highly specialized coating products.

Ontario is Canada's dominant province economically, accounting for more than 53 percent of Canada's total manufacturing shipments and 40 percent of its GDP. Its 11.3 million people represent 38 percent of Canada's population. For paints and coatings, Ontario is Canada's the most important market in many sectors. Home to the vast majority of automotive OEM activity in Canada, the province also occupies a commanding position in a number of other industry sectors. It offers a solid market to suppliers of heavy-duty coatings for demanding industrial applications, general industrial coatings, paints for plastics, electrocoats, ground transportation OEM and refinishing coatings, pleasure-boat coatings, metal and wood furniture coatings, and automotive refinishing paints as well as architectural coatings and road-marking paints.

The economy of the Prairie provinces (Manitoba, Saskatchewan and Alberta) is primarily focused on agriculture and oil & gas. Not as densely populated or heavily industrialized as neighboring Ontario, this region nevertheless offers interesting opportunities for providers of agricultural equipment maintenance coatings, high-performance coatings for the chemical and petrochemical industry, and specialized applications for the agriculture and food industries. One of the fastest growing areas in the country, the Prairies also offer interesting opportunities in the architectural paints segment and general industrial coatings.

Last but not least, the province of British Columbia (Canada's third largest province with 3.9 million people) and the Yukon Territory cover the Canadian West Coast. As is the case for nearly all of Canada, manufacturing and intensive economic activity occur in the southern part of this region, with northern activity more geared toward resource-based activities such as mining, forestry and fishing, which remain among the region's driving industries. While manufacturing, overall economic activity and population grew rapidly for several years, benefiting the recent Asia crisis has dampened this growth significantly. Though not as heavily oriented toward manufacturing as Ontario and Quebec, the region has developed a vibrant high-tech sector, and Vancouver, the country's third largest city, has the largest, most diversified port in Canada. The region should be particularly interesting to suppliers of marine coatings (vessels and offshore structures), yacht paints, general industrial coatings, rolling stock refinishing coatings, automotive refinishing paints and architectural coatings.

The paragraphs above briefly describe the principal elements and industrial structure of Canada's regional markets. Interested exporters should be aware that few businesses in Canada are active in only one or two areas. Sizable niche markets often exist for specific products in a given area, even if there is no intense industrial concentration there. One good example of this is agriculture. Even though the Prairie Provinces are generally seen as the main agricultural region in Canada, every region has significant agricultural activity, be it, fruit and vegetables in Ontario and British Columbia for example, or dairy farming in Quebec. A small exporter of paints for agricultural machinery may be inclined to tackle the Prairies market first, but it could be worth the company's while to consider entering Canada through niche markets in British Columbia instead, where the market may not be as saturated easier to penetrate.

Exporters interested in the Canadian market should be aware of the difficulties that can be encountered serving a given market because of the wide dispersal of manufacturing plants, even within the same region. For example, manufacturers of wooden doors, windows, kitchen cabinets, furniture and similar products, all important end-users of industrial coatings, are located mainly in Quebec and Ontario. The individual plants may be located outside large urban centers and are often quite distant suppliers with centralized service and distribution setups. These end-users are often relatively small accounts, yet they demand close technical cooperation multinationals may not be able to offer such personalized service to these smaller accounts for the local supplier, or the foreign supplier with good regional distribution arrangements, or the U.S. suppliers located close to the

border to serve Canadian clients on a regional basis, they represent interesting opportunities.

D. MARKET ACCESS

Canada presents no significant barriers to imports of paints and coatings no tariffs applied to imports satisfying the Rules of Origin requirements set under NAFTA. All tariffs not already eliminated as a result of the FTA or NAFTA (January 1, 1993 for most paints and coatings) were lifted on January 1, 1998 for products complying with the NAFTA rules of origin. Third-country imports not satisfying NAFTA rules of origin requirements but qualifying for Most Favored Nation (MFN) treatment generally face duty rates of 6.5 percent. This generally means a price advantage for U.S. suppliers. U.S. exporters seeking more information about the NAFTA rules of origin or the duty treatment of their products in Canada should contact Revenue Canada, the federal department responsible for administering Canadian tax laws (see the Key Contacts section of this report).

Taxes:

Effective January 1, 1991, the Canadian Goods and Services Tax (GST) replaced the Canadian Federal Sales Tax (FST). The new GST nets out at seven percent on a value-added basis at each resale of a product. Canadian importers must now remit seven percent of the duty-paid value of their imported merchandise to Revenue Canada. Importers are allowed to apply the tax they pay against any accrued tax liability resulting imported goods and remit the balance of their value added tax liability at that time.

Standards:

Standards for paints and coatings in Canada and the United States are generally comparable. For standards and certification information, interested parties should contact the Canadian General Standards Board, which is the main standardization body for paints and coatings in Canada (see Key Contacts section).

Paints and coatings being shipped into Canada must conform to Transport Canada's Transportation of Dangerous Goods Regulations and Act. Many paints and coating products are also subject to the dispositions of Canada's Hazardous Products Act, which, together with its related regulations, spells out the manufacturer's obligations and basic product rules including, for example, limits to the use of lead and mercury in paints. Specific information concerning the Hazardous Products Act can be obtained Canada. In the particular case of anti-microbial paints and coatings (anti-fouling or anti-fungal paints, pest control related coatings, wood preservatives, etc.), interested companies should contact Health Canada's Pest Management Regulatory Agency.

The centerpiece of Canada's regulatory framework on hazardous waste, the Canadian Environmental Protection Act of 1988 (CEPA), has established new standards for hundreds of toxic substances. Although the Canadian federal government department, Environment Canada, is responsible for environmental issues, each provincial Ministry of the Environment exercises more influence in establishing and enforcing guidelines and legislation within its jurisdiction.

Through the Canadian Paint and Coatings Association (CPCA), the industry works closely with the Canadian government to ensure that its member companies' products and processes conform to all legislative requirements. Thanks to this collaboration, raw material restrictions and environmental regulations have had little negative impact on the industry.

The Volatile Organic Compound (VOC) reduction question is one of the most important environment-related issues the industry has addressed in recent years. Charged Ministers of the Environment to develop standards for VOC reduction, Environment Canada has sought the industry's help in developing those standards. However, establishing specific targets, guidelines and regulations in an industry as technically diverse as paints and coatings is a daunting task. Specific working groups have been established jointly other industry associations to study the question. Many of the potential regulations discussed in those forums are based on U.S. standards and regulations. Particular attention has been given to the automotive coatings sector, with active working groups set up in the automotive OEM and automotive parts segments. A set of regulations concerning automotive refinishing products has been agreed upon recently and should come into force July 1, 1998. The next

segment the industry will address is furniture finishing. As architectural coatings manufacturers have already surpassed the VOC reduction targets set out Canada, the latter has agreed to sign a Memorandum of Understanding (MOU) with the manufacturers, recognizing their efforts, and establishing a yearly survey process to monitor the sector's progress on compliance.

Another of the industry's efforts in the environmental, and the health and safety area, is the Coatings Care initiative, which the Canadian Paint and Coatings Association recently adopted and is currently working to implement in Canada.

Labeling:

Products sold in the province of Quebec must be labeled in French and must meet all Canadian labeling requirements. All printed material that accompanies the products, including instructions for use and directions or warranties must be printed in English and French. Consumer packaging in Canada falls under the Consumer Packaging and Labeling Act (CPLA) and the Competition Act, both of which are administered Language requirements are more stringent in the province of Quebec, and the Office de la Langue Francaise should be contacted for details on language and product labeling requirements in that province (see Key Contacts section). U.S. exporters are encouraged to work with a local distributor or major retailer to meet product-specific requirements.

Financing:

In the Canadian paints and coatings industry, invoices are generally payable in 30 days, with a two-percent discount offered if payment is made shipment.

KEY CONTACTS

PLEASE NOTE: The following is an extensive list of contacts for U.S. firms seeking to engage in business activities with Canadian companies and government agencies. Contacts are listed alphabetically and, as such, no discrimination is intended, and no guarantee of reliability is implied. Additional information regarding the entities listed can be obtained directly.

Government/Organizational Contacts

Environment Canada 10 Wellington Street Hull, Quebec K1A 0H3 Tel: (819) 997-2800 Fax: (819) 953-2225 Internet: http://www.ec.gc.ca

Health Canada Pest Management Regulatory Agency 2250 Riverside Drive Ottawa, Ontario K1A 0K9 Tel: (613) 736-3708 Fax: (613) 736-3707 Internet: http://www.hc-sc.qc.ca

Industry Canada 235 Queen Street Ottawa, Ontario K1A 0H5 Tel: (613) 947-7466 Fax: (613) 954-6436 Internet: http://strategis.ic.gc.ca

Industry Canada (for federal labeling requirements) Competition Bureau Fair Business Practices Branch Place du Portage, 17th Floor 50 Victoria Street Hull, Quebec K1A 0C9 Tel: (819) 953-3650 Fax: (819) 953-2557

Office de la Langue Francaise (Office of the French Language -- for Quebec labeling requirements) Public Relations Services Tour Place Victoria, 16th Floor, P.O. Box 316 Montreal, Quebec H4Z 1G8 Tel: (514) 873-6565 Fax: (514) 873-3488 Internet: http://www.olf.gouv.qc.ca

Descriptors: Statistics; General News; Sales; Marketing; Company News

Country Names/Codes: Canada (CA)

Regions: Americas; North America; Pacific Rim

SIC Codes/Descriptions: 2851 (Paints & Allied Products)